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No. _____

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1996

DENBICARE U.S.A, INC., and ERNEST H. MCCOY,
Petitioners,
VS.
TOYS "R" US, INC.,
Respondent.

Petition For Writ of Certiorari
To The United States Court of Appeals
For the Ninth Circuit

PETITION FOR WRIT OF CERTIORARI

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54 pp

QUESTIONS PRESENTED

1. Should the First Sale Doctrine of statutory copyright law be applied to trademarks, in violation of this Court's repeated prohibitions, to cut off a trademark owner's basic right of quality control after the first sale of branded goods into commerce, whereby if those goods deteriorate in the chain of distribution, the trademark owner is prevented from affecting those goods which have become inferior to protect the public from those goods and the reputation of the mark?

2. Do allegations of unfair competition for the sale of smuggled goods at a price advantage in side-by-side comparison sales only "sound in trademark" whereby the claim is barred by the First Sale Doctrine of copyright law and does not constitute a violation of the Lanham Act because petitioners "failed to cite any authority the Lanham Act offers a remedy for the sale of 'smuggled' products at a price advantage" whereby petitioners have no legal right to stop the sale of competitive illegal smuggled goods?

3. Does a sale of not yet imported counterfeit goods while located in a Free Trade Zone of the United States nevertheless constitute a legitimate sale in the United States thereby giving First Sale Doctrine protection of the copyright law to those goods when they are subsequently smuggled into the United States and thereby defeat a copyright owner's right against importation under section 602 of the Copyright Act?

4. Does an injunction obtained in a United States Bankruptcy Court affecting specific counterfeit trademarked goods, and constituting an express restriction on resale reasonably related to quality control of those goods, *not* run with those goods, and is it not enforceable in a

United States District Court but only in the Bankruptcy Court?

5. Does a plaintiff by obtaining an injunction against any sale of specific goods in the United States before a bankruptcy sale of those goods, as a result, consent to such a sale, thereby defeating the exact prohibition of the injunction and invoking the First Sale Doctrine of copyright law to bar plaintiffs' copyright, trademark, and unfair competition claims?

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Petition For Writ of Certiorari
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For the Ninth Circuit

PETITION FOR WRIT OF CERTIORARI

DenbiCare U.S.A., Inc. (DENBICARE) and Ernest H. McCOY (McCOY) respectfully pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Ninth Circuit entered in this proceeding on May 24, 1996 (rehearing denied July 18, 1996) in order to resolve conflicts between the Ninth and other Circuit Courts of Appeal and to correct several erroneous decisions of first impression.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Ninth Circuit that gives rise to this petition was published and is reprinted in Appendix A hereto. By order filed

July 18, 1996, the Ninth Circuit denied the petition for rehearing and suggestion for rehearing *en banc.* Appendix B.

JURISDICTION

On October 5, 1989, the first District Court judge assigned to this case granted summary judgment to petitioners on the trademark causes of action. The Court also issued an order to show cause why it should not also grant summary judgment to petitioners on the common law unfair competition and Lanham Act § 43(a) claims. However, the Court dismissed petitioners' copyright infringement claim based on the First Sale Doctrine. Upon reconsideration, the Court rescinded its order of summary judgment and failed to rule on its Order to Show Cause.

On December 19, 1991, the second judge assigned to the case ruled that the First Sale Doctrine or the exhaustion rule barred petitioners' trademark claims.

On May 21, 1993, the Court dismissed petitioners' tortious denial of contract claim but allowed their breach of contract claim. In the same Order, the Court stated that petitioners' "unfair competition causes of action have been dismissed."

The case was then referred back to the first Judge for trial, but in August, 1994, he ordered final judgment entered with respect to all of petitioners' dismissed claims. Petitioners timely appealed to the Ninth Circuit which had jurisdiction under 28 U.S.C. § 1291 and affirmed in an opinion filed on May 24, 1996. On July 19, 1996, the Ninth Circuit denied petitioners' timely motion for rehearing with suggestion for rehearing *en banc.* Pursuant to Supreme Court Rule 13.1, this petition has been filed within 90 days of the denial of rehearing.

Jurisdiction of the Court is invoked pursuant to 28 U.S.C. § 1254(1).

STATUTES INVOLVED IN THIS CASE

Copyright Law § 109(a):

Limitations on exclusive rights: Effect of transfer of particular copy or phonorecord.

(a) Notwithstanding the provisions of section 106(3), the owner of a particular copy or phonorecord lawfully made under this title, or any person authorized by such owner, is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy or phonorecord.

Copyright Law § 602:

Infringing importation of copies or phonorecords.

(a) Importation into the United States, without the authority of the owner of copyright under this title, of copies or phonorecords of a work that have been acquired outside the United States is an infringement of the exclusive right to distribute copies or phonorecords under section 106, actionable under section 501. This subsection does not apply to—

(1) importation of copies or phonorecords under the authority or for the use of the Government of the United States or of any State or political subdivision of a State, but not including copies or phonorecords for use in schools, or copies of any audiovisual work imported for purposes other than archival use;

(2) importation, for the private use of the importer and not for distribution, by any person with respect to no more than one copy or phonorecord of any one work at any one time, or by any person arriving from outside the United States with respect to copies or phonorecords forming part of such person's personal baggage; or

(3) importation by or for an organization operated for scholarly, educational, or religious purposes and not for private gain, with respect to no more than one copy of an audiovisual work solely for its archival purposes, and no more than five copies or phonorecords of any other work for its library lending or archival purposes, unless the importation of such copies or phonorecords is part of an activity consisting of systematic reproduction or distribution, engaged in by such organization in violation of the provisions of section 108(g)(2).

(b) In a case where the making of the copies or phonorecords would have constituted an infringement of copyright if this title had been applicable, their importation is prohibited. In a case where the copies or phonorecords were lawfully made, the United States Customs Service has no authority to prevent their importation unless the provisions of section 601 are applicable. In either case, the Secretary of the Treasury is authorized to prescribe, by regulation, a procedure under which any person claiming an interest in the copyright in a particular work may, upon payment of a specified fee, be entitled to notification by the customs Service of the importation of articles that appear to be copies or phonorecords of the work.

Lanham Act § 43(a):

Title VIII—False Designations of Origin, False Descriptions, and Dilution Forbidden.

SEC. 43 (15 U.S.C. 1125) (a)(1) Any person who, on or in connection with any goods or services, or any container for goods, uses in commerce any word, term, name, symbol, or device, or any combination thereof, or any false designation of origin, false or misleading description of fact, or false or misleading representation of fact, which—

(A) is likely to cause confusion, or to cause mistake, or to deceive as to the affiliation, connection, or associ-

ation of such person with another person, or as to the origin, sponsorship, or approval of his or her goods, services, or commercial activities by another person, or

(B) commercial advertising or promotion, misrepresents the nature, characteristics, qualities, or geographic origin of his or her or another person's goods, services, or commercial activities, shall be liable in a civil action by any person who believes that he or she is likely to be damaged by such act.

(2) As used in this subsection, the term "any person" includes any State, instrumentality of a State, or employee of a State or instrumentality of a State acting in his or her official capacity. Any State, and any such instrumentality, officer, or employee, shall be subject to the provisions of this Act in the same manner and to the same extent as any nongovernmental entity.

Restatement (Third) of Unfair Competition, § 24, comment b (Tentative Draft No. 2, 1990)

The trademark owner ordinarily cannot prevent or control the sale of goods bearing its mark once the owner has allowed the goods to enter the marketplace. It can be said that the rights of the trademark owner are exhausted once it authorizes the initial sale of the product under its trademark, or that it impliedly licenses others to further distribute the product under the mark.

I.

STATEMENT OF THE CASE

This action arises under the laws of the United States relating to trademark and copyright infringement. The District Court has "federal question" subject matter jurisdiction under 28 U.S.C. §§ 1331, 1338, and 15 U.S.C. § 1121. The Complaint also alleges causes of action for unfair competi-

tion and tortious interference with contract under California state law; the District Court has subject matter jurisdiction of these claims under principles of pendent jurisdiction.

Petitioners petition for Writ of Certiorari to the District Court of Appeals for the Ninth Circuit based on the decision rendered May 24, 1996, affirming the District Court with several rulings of first impression which set inequitable precedent in multiple areas of the law and which particularly affect adversely the enforcement of trademark rights and the protection of the public.

A. There is No First Sale Doctrine or Exhaustion Rule in Trademarks

The Ninth Circuit Court of Appeals has affirmed a handful of cases, which are based on contradictory and flawed reasoning, by holding that the statutory First Sale Doctrine of copyright law or the exhaustion rule applies to trademarks and terminates a trademark owner's basic right to control the quality of goods after a first sale of the goods into commerce. The doctrine and rule eviscerate a trademark owner's most important right of quality control over goods which are subsequently altered, deteriorate, or go out of style in the chain of distribution due to mishandling, neglect, accident, or abuse, and prevent a trademark owner from protecting the public from those inferior goods. The doctrine and rule are exactly the opposite of the law of trademarks set forth by the cases and directly conflict with a trademark owner's basic need to maintain quality control of goods until they reach the consumer in order to protect the reputation of the mark and the public from goods which become inferior after their first sale into commerce.

The Court's decision, and the deviant line of similar cases, violate this Court's prior rulings cautioning against applying doctrine formulated in the law of either copyright or trademark to the other, and the rule and doctrine are directly

refuted by recent decisions of the Ninth Circuit as well as other United States Circuit Courts of Appeal.

B. The Sale of Smuggled Goods is Unfair Competition

The Ninth Circuit Court of Appeals acknowledged that petitioners have alleged in their complaint for unfair competition that the defendant "competed unfairly by selling smuggled diapers at a devastating price advantage," in side-by-side comparison sales. However, the Court of Appeals upheld the District Court's summary dismissal of the petitioners' unfair competition causes of action in the complaint because the allegations "sound in trademark" and are therefore barred by the First Sale Doctrine of copyright law. The Appeal Court added that the allegations do not constitute violation of the Lanham Act or California statutes because petitioners "failed to cite any authority indicating the Lanham Act offers a remedy for the sale of 'smuggled' products at a price advantage." The decision is quite obviously one of first impression, and the effect is essentially to destroy the right of *any* individual plaintiff to stop the sale of smuggled goods for any reason.

C. A Sale in a Free Trade Zone Granting First Sale Doctrine Protection to Not Yet Imported Goods Is Inequitable and in Conflict with Copyright Law

In a further critically important decision of first impression, the Ninth Circuit Court of Appeals has held that a sale of not yet imported counterfeit trademarked and copyrighted goods in a Free Trade Zone, notwithstanding a pre-existing injunction prohibiting any sale of those specific goods in the United States, is nevertheless a legitimate sale in the United States thereby giving First Sale Doctrine protection to those goods when they are subsequently smuggled into the United States. In addition to being irrational and inequitable, and the First Sale Doctrine historically not applicable to trademarks, the decision is in direct conflict

with a copyright owner's rights against importation under § 602 of the Copyright Act.

D. A Bankruptcy Injunction is Enforceable in a United States District Court

In yet another decision of first impression, the Ninth Circuit Court of Appeals has held that an injunction obtained in a United States Bankruptcy Court affecting specific trademarked goods, and constituting an express restriction on resale reasonably related to quality control of those goods, does not run with those goods and is not enforceable in a United States District Court. In contrast, similar restrictions, not judicially imposed, have been held to run. The holding is inconsistent with established and undisputed trademark law and severely restricts the right of a trademark owner to protect the public through restrictions on resale related to quality control.

E. Obtaining an Injunction Cannot Constitute Consent to the Act Proscribed

In still a further decision of first impression, the Ninth Circuit Court of Appeals has held that a plaintiff, by obtaining an injunction against any sale of specific goods in the United States before a bankruptcy sale of those goods, thereby consents to that sale for First Sale Doctrine purposes and, as a result, is thereby barred from later asserting the injunction except possibly only in the Bankruptcy Court. In addition to being inequitable, the decision is illogical and creates chaos for any party contemplating obtaining an injunction in a bankruptcy sale as well as in other federal courts concerning specific goods.

II.

STATEMENT OF RELEVANT FACTS

Petitioner McCOY purchased the intellectual property rights of petitioners' predecessor in 1985 at a bankruptcy sale. He formed petitioner DENBICARE and commenced making washable diapers under the purchased rights.

A little over a year later, the bankruptcy trustee noticed for sale and sold as "irregular diapers" the predecessor's left-over old inventory of Hong Kong-manufactured diapers which were packaged in petitioners' acquired copy righted packaging and both the packaging and the diapers bore petitioners' acquired trademark. The goods were being held in the Free Trade Zone of the Port of San Francisco because no one had paid the import duty. McCOY objected to the sale of the goods and obtained a stipulated injunction from the Bankruptcy Court, before the sale, that the goods could not be "sold, resold, distributed, or disposed of in the United States or Canada," where DENBICARE held the copyright and trademark rights. Shortly after the sale, the Hong Kong diapers appeared illegally in the U.S.

During subsequent contract negotiations with defendant/appellee TOYS "R" US ("TOYS") for the sale of legitimate DENBICARE diapers to TOYS, petitioners warned TOYS not to buy any of the old Hong Kong diapers which had been sold at the bankruptcy sale because they were defective, illegal, and violated petitioners' acquired rights. The Hong Kong diapers were smuggled into the U.S., sold to third-party defendant HARRIS, and ultimately resold to TOYS. TOYS then offered them as genuine perfect goods in competition with petitioners' diapers on the same shelves at one-third the price using petitioners' product as price comparison bait. Immediately, and before TOYS had sold the goods, or even paid for them, petitioners objected and repeated their earlier warnings, and demanded

that TOYS remove the goods from the stores. TOYS refused and petitioners brought suit in November, 1987.

The Court of Appeals held that McCOY, by obtaining the stipulated injunction at the bankruptcy sale, thereby consented to the sale for the purposes of the First Sale Doctrine and that a sale in a Free Trade Zone is a first sale in the United States. As a result, petitioners' copyright claim was barred. The Court then held that McCOY's consent likewise bars petitioners' trademark claims under the First Sale Doctrine of copyright Law or the exhaustion rule and that his injunction cannot be enforced in the District Court. The Court also barred petitioners' unfair competition claims against TOYS for selling smuggled diapers on the ground the allegations only "sound in trademark" whereby the First Sale Doctrine applies and because petitioners had not cited any authority that the activity violated the Lanham Act.

III.

REASONS FOR GRANTING THE WRIT

A. The First Sale Doctrine and the Exhaustion Rule Historically Do Not Exist in Trademark Law and Should Not Now

1. Copyright Principles Should Not be Applied to Trademark Cases

The Court of Appeals has relied upon the First Sale Doctrine and the exhaustion rule enunciated in the holding of *Sebastian Int'l, Inc. v. Longs Drug Stores Corp.*, 53 F.3d 1073 (9th Cir.), *cert. denied*, 116 S.Ct. 302 (1995), to deny petitioners' trademark claims. That case was cited to the

Court by the appellee in a supplemental brief, after briefing on appeal was completed, with the following summary:

> "The 'exhaustion doctrine' clearly applies to the first sale of trademarked goods. Recognizing that the 'first sale' doctrine in trademark law is well-established, this Court held that it provides a 'sensible and stable accommodation' to a trademark owner's right to mark its goods and control the quality of its products so marked but yet preserves an area for competition by limiting the producer's power to control the resale of its product . . .' The *Sebastian* Court found that 'courts have consistently held that, within certain well-defined exceptions, the right of a producer to control distribution of its trademarked product does not exceed beyond the first sale of the product' . . ."

However, the First Sale Doctrine is statutory copyright law and there is no comparable statute in trademark law. The two bodies of law exist to protect completely different property rights and the Supreme Court has cautioned repeatedly against applying doctrine formulated in one area to the other. See *Sony Corp. of American v. Universal City Studios*, 454 U.S. 417, 439, n.19 (1984). The exhaustion rule was created by committee and is set forth in the Restatement of Unfair Competition, § 24. Unfortunately, it states a rule exactly the opposite of established trademark law. It attempts to reverse decades of well-reasoned trademark law without judicial review.

It was demonstrated to the Court of Appeals that in order to analyze the applicability of the copyright First Sale Doctrine to a trademark (first sale) situation, a comparison must be made of what happens when products are sold into commerce under the two different property rights. A copyright protects only one specific unique embodiment of a copyright owner's work of art. When each copy of that particular work of art is sold into commerce, it sells down

the chain of distribution based solely on its own inherent economic and aesthetic appeal to the next purchaser. It is not a staple item of commerce which must compete with other identical goods. There is no good will associated with the sale of a work of art (unless it is sold in conjunction with a trademark) which would warrant the right of quality control. Once the work of art is sold, the statutory First Sale Doctrine puts the goods irretrievably into the stream of commerce and *caveat emptor*. The goods are thereafter treated like any non-trademarked item which enters the stream of commerce.

In comparison, a trademark may cover a line of different products which are usually staple items of commerce, not aesthetically unique, and which compete with many alternative choices. The sole function of a trademark is to carry a symbol of quality of the goods and reputation of the manufacturer, through the chain of distribution, to the consumer to distinguish the trademark owner's goods from those of others.

2. The First Sale Doctrine and the Exhaustion Rule Conflict with a Trademark Owner's Right of Quality Control

The First Sale Doctrine and exhaustion rule directly conflict with a trademark owner's absolute right of control of distribution under a mark, and the effect would be to eviscerate the continuing right of quality control over the goods through the chain of distribution necessary for a trademark owner to protect the reputation of the mark and the public from goods which become inferior.

The trademark issues in this case are controlled by *A. Bourjois & Co. v. Katzel*, 260 U.S. 689 (1923) (Holmes, J.). In *Bourjois*, this Court held that after a trademark owner sells his United States trademark rights to someone else, a third party cannot sell genuine foreign-made goods in

the United States under that mark. In this case, the bankruptcy trustee sold the DENBI mark and its associated goodwill to petitioners, retaining no trademark rights. Petitioners' predecessor had not sold the Hong Kong diapers into commerce when it owned the mark; the old branded diapers in the old copyrighted and trademarked packaging were still being held by the trustee. Thus, after the trustee sold the trademark, under *Bourjois*, no one except petitioners had the right to sell those diapers or any others under the mark. Under *Bourjois*, the old Hong Kong diapers ceased to be genuine goods once the trustee sold the trademark to petitioners; the diapers and their packaging were automatically converted into counterfeit product when the mark was sold, and neither the trustee, HARRIS, nor TOYS, nor anyone else had any right to sell them under the mark (or the copyright).

The absolute control over distribution under a mark conferred by *Bourjois* is founded on a trademark owner's fundamental right to quality control:

> "One of the most valuable and important protections afforded by the Lanham Act is the right to control the quality of the goods manufactured and sold under the holder's trademark. [Citation omitted.] For this purpose, the actual quality of the goods is irrelevant: It is the control of quality that a trademark holder is entitled to maintain."

El Greco Leather Prods. Co. v. Show World, Inc., 806 F.2d 392, 395 (2d Cir. 1986), *cert. denied*, 484 U.S. 817 (1987). The essential question is what does the right to "maintain" quality control mean. A trademark owner has absolute control over quality prior to the release of goods into commerce, but, if a trademark owner cannot control the quality of goods after the first sale, and through the chain of distribution, the owner is unable to maintain control of quality at all. This right is essential to maintaining the

reputation of the mark until the goods reach the consumer and to protect the public from inferior goods. Therefore, if a trademark owner's rights of quality control are essentially inherent and non-utilized before the goods are released into commerce, the right of quality control, instead of lapsing or being exhausted when the goods are released, actually just commences to be needed or to exist at that point in time. However, the right is unusable unless a condition subsequent occurs affecting the quality of the goods to catalyze and activate the power and right to affect the further distribution of those goods. The real rule in actuality is the exact reverse of the exhaustion rule: instead of being exhausted at the time of the first sale, the right is actually activated even though it is inert and requires a condition subsequent to become useable.

The exhaustion rule just describes what *normally* happens with most trademarked goods. Usually, nothing happens to them in the chain of distribution to cause them to become inferior and activate the trademark owner's right of quality control. They pass through commerce after the first sale the same as non-trademarked (or copyrighted) goods. The exhaustion rule ignores the numerous unrelated exceptions to it, and under normal rules of logic the rule would be destroyed by any one of them.

The court in *Sebastian, supra*, relied on *Prestonettes, Inc. v. Coty*, 264 U.S. 359, 68 L.Ed. 731, 44 S.Ct. 350 (1924), which only holds that a trademark owner cannot block downstream distribution of *unaltered, perfect* branded goods after the first authorized sale. When the owner of a trademark sells branded goods into commerce, they may become inferior during movement through distribution by mishandling, neglect, accident, or abuse. The cases empower a trademark owner to step in after the first sale to protect the reputation of a mark and the public against inferior quality goods. *Prestonettes* does not tie the hands of a trademark

owner seeking to stop distribution of out-of-date/style, altered, relabeled, or deteriorated branded goods.

For example, in *Shell Oil Co. v. Commercial Petroleum, Inc.*, 33 F.Supp. 40 (W.D.N.C. 1989), aff'd, 928 F.2d 104 (4th Cir. 1991), the court found that Shell could control the continuing quality of unpackaged bulk oil only through action after the first sale. Therefore, the court allowed Shell to exercise control over the handling, storage, and transportation practices of its authorized dealers. If a trademark owner has no right of quality control after the initial sale, then the trademark owner has no greater rights of quality control than a manufacturer who uses no mark.

3. There is an Implied License Which Runs with Trademarked Goods

The Appeal Court held that McCOY consented to the bankruptcy sale by obtaining the injunction. While the holding of consent is disputed by petitioners, if he did consent, then the injunction attached a conditional implied license to the goods which barred any sale in the United States, and that result is consistent with all prior trademark decisions dealing with downstream control of goods. Implied licenses which run with the goods are generally accepted as the basis for permitting resale of patented goods but have not been recognized in trademark cases. However, the Restatement of Unfair Competition states that an alternative to the exhaustion rule is that the trademark owner "impliedly licenses others to further distribute the product under the mark."

When a trademarked item is sold into commerce, as a general rule, an implied license for resale under the mark attaches which runs with the goods. However, the implied license carries implied conditions and can be further preconditioned with restrictions on the resale. A first implied condition: the licensee must maintain the quality of the

goods until they reach the consumer. A second implied condition: the licensee may not alter the goods or the trademark owner's implied or express representations of their age, quality, and characteristics. Third, express conditions can also run with the goods if they are reasonably related to quality control. The following cases illustrate these rules for implied licenses.

In *Adolph Coors Co. v. A. Gunderson & Sons, Inc.* 486 F.Supp. 131 (D. Colo. 1980), the court ruled that Coors could stop the sale of stale beer on an unfair competition theory. Under implied license theory, the defendant violated the implied condition to maintain quality. Similarly, in *Polaroid Corp. v. Blue Dot Corp.*, 214 U.S.P.Q. 192 (D.N.J. 1981), defendant altered the expiration date on photographic film to create the false impression that the film was new. The film was not altered and may have been perfect; defendant altered only representations made by the trademark owner. The court enjoined the practice under an unfair competition theory. Under implied license theory, the defendant violated implied conditions to maintain quality of the goods (by selling the film before the trademark owner's pre-set time limit), and not to alter representations made by the trademark owner (by changing the expiration date), and an express condition (not to offer the film for sale after the expiration date).

In the *J.C. Penney* cases, the sale of out-of-date/style goods was prohibited as unfair competition. *J.C. Penney Co. v. Parrish Co.*, 335 F.Supp. 209 (D. Idaho 1971); *J.C. Penney Co. v. Charbeth's Little General Store*, 185 U.S.P.Q. 254 (E.D. N.Y. 1975). The goods had not changed in quality but the sales violated the implied condition not to misrepresent the age of the product.

In the recent Ninth Circuit case of *Intel Corp. v. Terabyte Int'l, Inc.*, 6 F.3d 614 (1993), the Court held that a downstream distributor who "remarked" slower math co-

processors as faster, more expensive co-processors, committed trademark infringement. The Court in effect held that Terabyte violated an implied condition not to alter the trademark owner's statements of product characteristics. This holding refutes the First Sale Doctrine and directly conflicts with the Ninth Circuit's ruling in *Sebastian, supra*, relied on by the Court.

Express conditions can run with an implied license. In *Clairol, Inc. v. Boston Discount Center, Inc.*, 608 F.2d 1114 (6th Cir. 1979), Clairol restricted resale of its products to hair care professionals; further sales to the public were enjoined by the court as unfair competition. Unauthorized sales to the public violated an express condition reasonably related to quality control which ran with the goods.

Here, petitioners bought the DENBI trademark from the Bankruptcy Court, and under *A. Bourjois v. Katzel, supra*, the right of quality control immediately vested in petitioners. The old Hong Kong diapers held by the trustee in storage were automatically converted by that sale into counterfeit salvage goods. When they were sold, the sale was without a license for resale in the U.S. The injunction obtained by McCOY prohibited any sale where he held trademark rights. This was an express condition related to quality control which attached to the goods.[1]

In holding that petitioners' Bankruptcy Court injunction is not enforceable in the District Court and does not run with the goods, the District Court relied on a copyright case; *U.S. v. Wise*, 550 F.2d 1180, 1187, n.10 (9th Cir.) *cert. denied*, 434 U.S. 929, *reh'g denied*, 434 U.S. 977 (1977) as does the Appeal Court. *Wise*, however, concerns the statutory First Sale Doctrine of copyright law and is therefore

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[1] If implied conditions run under an implied trademark resale license, then the injunction—which listed express conditions related to quality control—must run.

inapplicable because copies of goods protected by the doctrine are never subjected to a conditional resale license as are trademarked goods under implied resale license theory. Copyrighted goods are treated like non-trademarked goods. If McCOY consented to the bankruptcy sale of the Hong Kong diapers, then, at most, the Court should find that McCOY granted an implied license for resale which included the express conditions set forth in the injunction. Those restricted resale conditions of McCOY's injunction are identical in nature to the express prohibition in *Clairol, supra.*

The facts of *Sebastian, supra*, relied upon by the Court of Appeal for applying the First Sale Doctrine of copyright law to trademarks, differ from this case. After the plaintiffs in *Sebastian* sold their goods into commerce, nothing occurred subsequently to catalyze the need for the trademark owner to enforce the continuing right of quality control. Unlike this case, the plaintiffs there could not allege a violation of any condition which ran with the implied license, so there was no trademark infringement, or need to maintain quality control, or to protect the public, to justify restraining the resale of the goods.

4. McCoy's Alleged Consent to the Bankruptcy Sale Is of No Legal Effect or It Was Conditioned

If the copyright First Sale Doctrine is not applied in trademark law, then McCOY's implied consent to the Bankruptcy sale, *of salvage goods*, is of no consequence because a first sale has no effect on petitioners' continuing rights of quality control *or to prevent trademark infringement.* For trademark infringement purposes, it is immaterial whether he obtained the injunction or not. Under *A. Bourjois v. Katzel, supra*, he could subsequently object when infringement occurred by an offer of sale of the diapers *under the mark to consumers.* There was no infringement of

the trademark by the bankruptcy sale of the "irregular diapers" because it was of salvage goods, not a sale under the trademark, and it was not to consumers or customers of petitioners. Until infringement subsequently occurred by such a sale, the diapers were simply rags in transit.

However, petitioners dispute the Court's finding of consent by McCOY because it did not occur or, if it is implied, then it was conditional. He obtained an injunction that the goods could not be "sold . . . in the United States." McCOY's objection was not converted into consent even though he may not have realized that a sale of goods in the Free Trade Zone could be a sale in the United States. McCOY's failure to anticipate the effect of the sale does not convert his specific objection to any sale in the U.S. into consent to such a sale. There is no evidence in the record to support the Appeal Court's factual finding that "McCOY stipulated in court that the sale could proceed if the buyers were enjoined" and it did not happen. Whether he consented or not is a factual question for the jury; not one to be resolved on a summary judgment motion.

B. The Court's Decision Overlooks the Fact that the Complaint Contains Allegations of False Advertising Under the Lanham Act

The Appeal Court, in its ruling affirming summary dismissal of petitioners' unfair competition claims, acknowledges that petitioner DENBICARE alleges in its complaint that TOYS "competed unfairly by selling smuggled diapers at a devastating price advantage" in side-by-side comparison sales. However, the Court found that the activity does not constitute unfair competition, because petitioners' allegations only "sound in trademark" and are barred by the First Sale Doctrine of copyright law, nor is it a violation of the Lanham Act or California statutes because petitioners "failed to cite any authority the Lanham Act offers a

remedy for the sale of 'smuggled' products at a price advantage."

Petitioners argued that even if the complaint only sounds in trademark, there are also sufficient allegations to state a false advertising cause of action under § 43(a) for selling the subject diaper pants without revealing to the public that they were irregular, illegal and/or smuggled. Petitioners cited *U-Haul Int'l, Inc., v. Jartran, Inc.*, 522 F.Supp. 1238, 1247 (D. Ariz. 1981) ("A statement actionable under the Lanham Act may be an affirmatively misleading statement, a partially incorrect statement, or *a statement which is untrue as a result of a failure to disclose a material fact*"), and *Oil Heat Institute of Oregon v. Northwest Natural Gas*, 708 F.Supp. 1118, 1121 (D. Or. 1988) (A deception is material if "... it is likely to influence the purchasing decision ..."). Clearly, the fact that a product is old, irregular, illegal and/or smuggled would influence the decision of a prospective customer whether to purchase the product.

C. The Decision Overlooked the Fact That the Diapers Were Old and Sold by the Bankruptcy Court as Irregular

Authority in the record cited by petitioners establishes that the Hong Kong diapers held by the trustee were old, and in the trustee's Notice of Sale the goods were labeled as "irregular diapers." Thus, even if it is true that McCOY consented to the sale of the diapers, they were sold as "irregular" salvage goods. In addition, the record is sufficient to establish, under summary judgment standards, that TOYS knew the goods were old and irregular when it bought and resold them.

TOYS' conduct is identical to that in *J.C. Penney Co. v. Charbeth's Little Gen. Store*, 185 U.S.P.Q. 254, 255-256. There, the court held it was unfair competition to sell goods

bearing plaintiff's trademark which are "either several years old, discontinued and/or out of style . . . as current, first quality merchandise," and unfair competition to make such sales "at prices which are substantially lower than plaintiff's prices for current, similar merchandise . . . " because it "may cause the public to believe plaintiff is making an inordinately high profit on its merchandise and is guilty of overcharging the public." Here, the subject diapers were over three years old when TOYS offered them for sale. Therefore, under *J.C. Penney*, TOYS' sale of such "several years old" smuggled goods as first quality constitutes unfair competition under the Lanham Act.

D. Unfair Competition Occurs When Illegal Smuggled Goods are Sold in Competition With Legitimate Goods

The Court's holding dismissing petitioners' unfair competition claims overlooks that the allegation re smuggled diapers was primarily made as part of DENBICARE's complaint of common law unfair competition. The Court only discusses petitioners' "passing off" common law unfair competition claim and ignores the essential allegation. Unfair competition is mainly a common law tort, only partially or occasionally codified or defined by statute. It has long been the rule that "unfair competition consists in selling goods by means which shock judicial sensibilities." *Margarite Steiff, Inc. v. Bing*, 215 F. 204 (D.C.N.Y. 1914). Petitioners submit that there can be no more egregious form of common law unfair competition than selling illegal goods in competition with legitimate goods at a tremendous price advantage. To bar petitioners' unfair competition claims because they "sound in trademark" and are barred along with petitioners' trademark claims based on the First Sale Doctrine of copyright law is unprecedented and unjustified.

E. A First Sale for Copyright Law Protection Cannot Equitably Occur in a Free Trade Zone

A sale of counterfeit (copyrighted) foreign-made goods in a Free Trade Zone, when the import duty has not been paid, should not constitute a legitimate first sale in the United States under the copyright laws, giving the protection of the First Sale Doctrine to those goods when they subsequently are smuggled into the United States, *even if the copyright owner consented to the sale.* Such a holding is inequitable and defeats a copyright owner's protection against importation of goods sold abroad under 17 U.S.C. § 602. The legal condition of goods sold in a Free Trade Zone where the import duty has not been paid on the goods is the same as goods sold abroad.

IV.

CONCLUSION

Ignoring petitioners' efforts to stop the sale of illegal goods, the Appeal Court's dismissal of all of petitioners' causes of action is based *solely* on the factual determination that McCOY consented to the bankruptcy sale whereby the First Sale Doctrine was invoked to bar their copyright, trademark, and unfair competition claims. However, McCOY objected to the very act deemed consented to and obtained an injunction to that effect. Further, there is no evidence in the record to support the Court's factual finding of consent.

The question of whether McCOY consented to the sale is a question of fact for the jury: not one for the Court on a summary judgment motion. The summary dismissal of all of petitioners' claims based on a factual finding of consent to invoke the First Sale Doctrine against copyright, trademark, and unfair competition claims was improper.

DATED: August 20, 1996

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APPENDIX A

APPENDIX A

FOR PUBLICATION

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

DENBICARE U.S.A. INC., and ERNEST MCCOY,
Plaintiffs-Appellants,

v.

TOYS "R" US, INC.,
Defendant-Appellee.

No. 94-16615

D.C. No. CV-87-05746-TEH

OPINION

Appeal from the United States District Court
for the Northern District of California
Thelton E. Henderson and Fern M. Smith,
District Judges, Presiding

Argued and Submitted
February 14, 1996—San Francisco, California

Filed May 24, 1996

Before: Arthur L. Alarcon, Edward Leavy, and Andrew J. Kleinfeld, Circuit Judges.

Opinion by Judge Leavy

SUMMARY

Intellectual Property/Litigation and Procedure (Civil)/ Patents

The court of appeals affirmed a district court's partial final judgment. The court held that it had appellate jurisdiction over a partial final judgment on nonpatent issues where the district court eliminated all patent claims from the case and

sufficiently separated out the nonpatent issues. The court also held that a sale in a foreign trade zone was a sale in the United States sufficient to bring a relevant "first sale" copyright statute into play.

Denbi Products, Inc. (DPI) sold reusable diapers made according to a design patented by Debra Shaw. DPI ordered a large quantity of diapers from its Hong Kong manufacturer. The diapers were shipped to the United States and held in a foreign trade zone awaiting DPI's payment of import duties.

DPI filed for bankruptcy. At a trustee's sale, appellant Ernest McCoy purchased DPI's United States and Canadian patents on the diapers, its copyrights in the packaging, and its trademarks. McCoy formed appellant Denbicare U.S.A. Inc. and licensed the purchased intellectual property rights to it. Denbicare began making and selling reusable diapers. Appellee Toys "R" Us, Inc. purchased diapers from Denbicare.

DPI's bankruptcy trustee applied to the bankruptcy court for approval of a sale of the Hong Kong diapers, which were still in the foreign trade zone, to Marc Rosenberg and Raul Martinez. McCoy objected to the sale because of his ownership of the United States patents, trademarks, and copyrights, and asked the court to confirm the sale only in conjunction with issuance of a permanent injunction against "selling, reselling, distributing or disposing" of the diapers in the United States or Canada. The bankruptcy court entered such an injunction, and McCoy registered no further objection. The court approved the sale.

Clark Harris bought some of the Hong Kong diapers from Martinez, and in turn sold the diapers to Toys under a contract. Denbicare discovered that Toys was selling the diapers in the original copyrighted boxes (bearing the original trademark). Denbicare sued Toys in the United States District Court for the Northern District of California, alleging patent infringement, copyright infringement, trademark infringe-

ment, unfair competition, breach of contract, and tortious bad-faith denial of contract.

Denbicare moved for dismissal of its claim for patent infringement. Toys opposed that motion and sought leave to amend its answer to add a counterclaim seeking a declaratory judgment that Denbicare's patents were invalid. The court granted Denbicare leave to amend its complaint to dismiss the patent infringement claim with prejudice. The court also granted Toys leave to amend, but later dismissed the counterclaim.

The court granted Toys' motion for summary judgment on Denbicare's claim of copyright infringement. The case was transferred to a different judge, who ruled against Denbicare on its trademark claims. The judge granted Toys' motion for summary judgment on the claim of tortious denial of contract. The case was reassigned to another judge for trial.

The parties and the court agreed that the court should enter a partial final judgment under Fed. R. Civ. P. 54(b) on its summary judgment rulings against Denbicare on the copyright, trademark, unfair competition, and tortious denial of contract claims in order to allow Denbicare to appeal those rulings. The trial on the remaining contract issue was stayed. Denbicare and McCoy appealed. Toys moved to dismiss the appeal, arguing that appellate jurisdiction lies properly in the Court of Appeals for the Federal Circuit.

[1] The Federal Circuit has exclusive jurisdiction over appeal from final district court decisions when the district court's jurisdiction "was based, in whole or in part," on certain patent provisions. Under relevant portions of a statute, a district court has jurisdiction over actions "arising under any Act of Congress relating to patents." [2] The fact that the appeal related only to nonpatent issues did not mean that jurisdiction was not in the Federal Circuit. [3] Both Denbicare's patent claim and Toys' counterclaim for a declaratory

judgment that Denbicare's patents are invalid were dismissed by the district court. [4] However, the dismissals of the patent claims were contested. [5] The legislative history of the law that created the Court of Appeals for the Federal Circuit indicated that there was appellate jurisdiction. [6] Because the district court both dismissed all patent claims from the case and separated its decision on the merits of the nonpatent claims through the grant of a partial final judgment under Rule 54(b), there was appellate jurisdiction over the partial final judgment.

[7] In regard to Denbicare's claim that Toys infringed its exclusive right to distribution in a copyrighted work (the box in which the diapers were packaged) through the sale of copies imported without authorization, Toys did not violate Denbicare's exclusive distribution right. The diapers were already in the United States. The relevant statute bars unauthorized importation only of copies acquired outside of the United States.

[8] Denbicare's exclusive distribution right was limited by the "first sale" doctrine. [9] In this case, there was a sale in the United States by the copyright owner or with its authority. The foreign trade zone is part of the United States. The bankruptcy trustee's sale of the diapers in the foreign trade zone was a sale in the United States sufficient to bring the relevant "first sale" statute into play. [10] McCoy consented to the first sale (the sale of the diapers by the bankruptcy trustee), although with a restriction that the buyers not resell the diapers in the United States or Canada.

[11] In regard to the trademark claims, because the trustee's sale qualified as a first sale for copyright purposes, it was a trademark first sale as well.

COUNSEL

Ernest H. McCoy, Bruce & McCoy, Oakland, California; Christopher J. Palermo, Fish & Richardson, Menlo Park, California, for the plaintiffs-appellants.

Paul Fields, Darby & Darby, New York, New York; Neil A. Smith, Limbach & Limbach, San Francisco, California, for the defendant-appellee.

OPINION

LEAVY, Circuit Judge:

Denbicare U.S.A. Inc. ("Denbicare") and Ernest H. McCoy appeal from a partial final judgment entered under Rule 54(b) after grants of summary judgment against them on their claims of copyright infringement, trademark infringement, unfair competition, and tortious denial of contract against Toys "R" Us ("Toys"). We have jurisdiction under 28 U.S.C. § 1291 and affirm.

FACTUAL BACKGROUND

Denbi Products, Inc. ("DPI"), a California company founded in 1981, sold reusable diapers made according to a design patented by its president, Debra Shaw. In 1983, DPI ordered a large quantity of diapers from its Hong Kong manufacturer. Approximately 450,000 diapers (the "Hong Kong diapers") were shipped by the manufacturer to the United States and held in the foreign trade zone[1] in San Francisco

[1]A foreign trade zone is "a restricted-access site, in or adjacent to a Customs port of entry." 15 C.F.R. § 400.2 (1995). "Goods that are in these zones may be stored, sold, exhibited, broken-up, repacked, assembled, distributed, sorted, and mixed with foreign or domestic merchandise without being subject to customs laws. Through these zones, United States citizens

awaiting DPI's payment of import duties. The parties dispute whether these diapers were defective, but Denbicare does not dispute that DPI did not formally reject the diapers as defective.

DPI filed for bankruptcy in the Northern District of California in 1984. At a trustee's sale in September 1985, McCoy purchased DPI's United States and Canadian patents on the diapers, its copyrights in the packaging, and its trademarks. McCoy then formed Denbicare, became its president, and licensed the purchased intellectual property rights to it; Denbicare began making and selling reusable diapers. Toys purchased diapers from Denbicare.

In November 1986, DPI's bankruptcy trustee applied to the bankruptcy court for approval of a sale of the Hong Kong diapers, which were still in the foreign trade zone, to Marc Rosenberg and Raul Martinez. McCoy objected to the sale because of his ownership of the United States patents, trademarks, and copyrights, and asked the court to confirm the sale only in conjunction with the issuance of a permanent injunction against "selling, reselling, distributing or disposing" of the diapers in the United States or Canada. The bankruptcy court entered such an injunction on December 4, based on the "stipulation of [McCoy and the purchasers] in open court." McCoy registered no further objection and the court approved the sale on December 29, 1986.

In March 1987, Denbicare's CEO and its manufacturers representative met with a Toys buyer at Toys' headquarters in Paramus, New Jersey. The meeting concerned Toys' inventory of Denbicare diapers, which was packaged in a format

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[can] be involved in and, consequently financially profit from the breaking down, repacking and relabelling of the goods." *Ocean Garden, Inc. v. Marktrade Co.*, 953 F.2d 500, 504 (9th Cir. 1991) (citations and internal quotation marks omitted).

that Denbicare was no longer using. The parties dispute whether an agreement was reached at this meeting concerning the repackaging of this inventory and what the terms of any such agreement were.

Clark Harris, doing business as Clark Harris Sales, bought about 235,000 of the Hong Kong diapers from Jaime Martinez, and in turn sold the diapers to Toys under a contract dated August 17, 1987. Neither Harris nor Toys had any notice of the bankruptcy court's injunction or any reason to believe that the diapers were not legally in the United States and freely marketable. Denbicare discovered in October 1987 that Toys was selling the diapers in the original copyrighted boxes (bearing the original trademark) and attempted unsuccessfully to persuade Toys to remove the diapers from sale. Toys attempted unsuccessfully to persuade Harris to take back the diapers.

PROCEDURAL HISTORY

In November 1987, Denbicare brought this action in the United States District Court for the Northern District of California alleging patent infringement, copyright infringement, trademark infringement, unfair competition, breach of contract, and tortious bad-faith denial of contract. At Denbicare's request the district court enjoined sale of the Hong Kong diapers.

In January 1989, after a two-day hearing, then-Magistrate Judge Claudia Wilken found that the diapers were not defective. The district court dissolved the injunction against sale in May 1989, but did not adopt Judge Wilken's finding that the diapers were not defective, stating that the issue of defectiveness was to be decided at trial.

Denbicare moved for dismissal of its claim for patent infringement. Toys opposed the motion and sought leave to amend its answer to add a counterclaim seeking a declaratory

judgment that Denbicare's patents were invalid. The district court granted Denbicare leave to amend its complaint pursuant to Federal Rule of Civil Procedure 15 to dismiss the patent infringement claim with prejudice. The district court also granted Toys leave to amend, but asked the parties to brief whether it had jurisdiction to hear the counterclaim under the Declaratory Judgment Act. After briefing, the district court found that Toys potential for liability was "purely speculative," and dismissed the counterclaim under *Societe de Conditionnement en Aluminium v. Hunter Eng'g Co.*, 655 F.2d 938, 944 (9th Cir. 1981), which requires a party seeking a declaratory judgment of patent invalidity to demonstrate "a real and reasonable apprehension that he will be subject to liability" for his activity.

On October 5, 1989, the court granted Toys' motion for summary judgment on Denbicare's claim of copyright infringement. At the same time, the court granted Denbicare's motion for summary judgment on its trademark infringement claims, but on November 7 it granted Toys' motion for reconsideration and denied summary judgment on the trademark claims.

Although the case had been set for trial in November 1989, the Loma Prieta earthquake in October of that year forced a delay until March 1991. Meanwhile, the case was transferred to Judge Fern Smith, who referred it to a magistrate judge and then adopted his recommendation that she review the trademark claims de novo. In December 1991, Judge Smith ruled against Denbicare on its trademark claims. In May 1993, Judge Smith granted Toys' motion for summary judgment on Denbicare's claim of tortious denial of contract. In October 1993, the case was reassigned to Chief Judge Henderson for trial.

As the trial was set to begin, Clark Harris was unable to appear because of a serious back injury he had just suffered. In the interests of judicial economy, the parties and the court

agreed that the court should enter a partial final judgment under Rule 54(b) on its summary judgment rulings against the plaintiff on the copyright, trademark, unfair competition, and tortious denial of contract claims in order to allow the plaintiff to appeal those rulings; the trial of the remaining contract issue was stayed pending a decision on appeal. Denbicare and McCoy timely appealed.

JURISDICTION

Toys moved to dismiss this appeal, arguing that appellate jurisdiction in this case lies properly in the Court of Appeals for the Federal Circuit.

I. Discussion

[1] The Federal Circuit has exclusive jurisdiction under 28 U.S.C. § 1295(a)(1) over appeals from final district court decisions when the district court's jurisdiction "was based, in whole or in part," on the patent provisions of 28 U.S.C. § 1338.[2] A district court has jurisdiction under the relevant portions of § 1338 over actions "arising under any Act of Congress relating to patents." The Supreme Court has held that the standards for determining whether an action "arises under" the patent laws are the same as those for determining whether an action "arises under" federal law for purposes of the general federal-question jurisdiction granted in 28 U.S.C. § 1331 and include the well-pleaded-complaint rule. *See, e.g., Christianson v. Colt Indus. Operating Corp.*, 486 U.S. 800, 807-809 (1988).

[2] The mere fact that the present appeal relates only to nonpatent issues does not mean that jurisdiction is not in the Federal Circuit. "[W]hen the district court's jurisdiction is based in part on § 1338, the appeal of the *entire case*, not

[2]For a general discussion of the patent jurisdiction of the Federal Circuit, *see* Donald S. Chisum, 3 *Patents* § 11.06[3][e] (1995).

solely the patent claims, lies in" the Federal Circuit. *Schwarzkopf Dev. Corp. v. Ti-Coating, Inc.*, 800 F.2d 240, 244 (Fed. Cir. 1986) (emphasis supplied). *See also Abbott Lab. v. Brennan*, 952 F.2d 1346, 1349-50 (Fed. Cir. 1991) ("The path of appeal is determined by the basis of jurisdiction in the district court, and is not controlled by the district court's decision or the substance of the issues that are appealed."), *cert. denied*, 505 U.S. 1205 (1992). The Federal Circuit has also held that it has exclusive appellate jurisdiction "when a nonfrivolous well-pleaded compulsory patent law counterclaim is present in a case originally and properly filed in the district court." *Aerojet-General Corp. v. Machine Tool Works, Oerlikon-Buehrle Ltd.*, 895 F.2d 736, 741 (Fed. Cir. 1990). *See also Xeta, Inc. v. Atex, Inc.*, 825 F.2d 604 (1st Cir. 1987).

[3] As discussed above, both Denbicare's patent claim and Toys counterclaim for a declaratory judgment that Denbicare's patents are invalid were dismissed by the district court. The propriety of these dismissals is not before us in this appeal, although, by opposing the dismissals, Toys has preserved its right to raise the issue in a subsequent appeal.

[4] A district court's dismissal of all patent claims or patent counterclaims, when unopposed, will remove the appeal of a district court decision on nonpatent issues from the exclusive jurisdiction of the Federal Circuit. *See Gronholz v. Sears, Roebuck and Co.*, 836 F.2d 515, 518 (Fed. Cir. 1987); *Schwarzkopf Dev. Corp.*, 800 F.2d at 245. Here, however, while all patent claims have been dismissed from the case, the dismissals were contested. We must decide whether we, nonetheless, have jurisdiction over the appeal of a partial final judgment granted under Rule 54(b) on certain nonpatent issues.

[5] The legislative history of the Federal Courts Improvement Act of 1982, the law that created the Court of Appeals for the Federal Circuit, indicates that we have jurisdiction.

The report of the House Judiciary Committee states that "[s]hould questions legitimately arise respecting ancillary and pendent claims and for the direction of appeals in particular cases, the Committee expects the courts to establish, as they have in similar situations, jurisdictional guidelines respecting such cases." H.R. Rep. No. 97-312, 97th Cong., 1st Sess. 41. One prominent commentator has suggested the use of Rule 54(b) in such situations: "If there is to be any such division and channeling of appeals, the appropriate vehicle would seem to be the procedures and standards already developed under Rule 54(b). . . ." Chisum, *Patents* § 11.06[3][e][iii]. In addition, at least one circuit has suggested this approach. In *Unique Concepts, Inc. v. Manuel*, 930 F.2d 573 (7th Cir. 1991), Judge Easterbrook rejected a patent plaintiff's argument that the regional circuit had jurisdiction over its appeal of a judgment against it on the defendant's state-law counterclaims heard in diversity, even though the patent claims had been bifurcated for trial after the state-law claims and the plaintiff, after losing on the latter claims, was granted leave (conditioned on execution of a covenant not to refile) to dismiss its patent claims without prejudice. The court noted that "[i]f the district judge had used Fed. R. Civ. P. 54(b) to separate the [state-law] claims from the patent claims, then [plaintiff] would have a better argument. That final decision really would depend wholly on § 1332 [for jurisdiction]."[3] 930 F.2d at 575.

[6] The Senate Judiciary Committee Report also lends support to this approach. That committee expressed concern that parties might insert patent claims into a case in order to avoid the appellate jurisdiction of the relevant regional circuit; it gave the example of a plaintiff who joined a patent claim to "a case whose gravamen is antitrust." S. Rep. No. 97-275, 97th Cong., 1st Sess. 20 (1981), *reprinted in* 1982

[3]The court noted, however, that it "need not decide whether Rule 54(b) can be used to direct an appeal to a particular circuit." *Id.*

U.S.C.C.A.N. 11, 30 (hereinafter *Senate Report*). The report explained how to avoid this problem:

> Federal District judges are encouraged to use their authority under the Federal Rules of Civil Procedure, *see* Rules 13(i), 16, 20(b), 42(b), 54(b), to ensure the integrity of the jurisdiction of the federal court of appeals by separating final decisions on claims involving substantial antitrust issues from trivial patent claims, counterclaims, cross-claims, or third party claims raised to manipulate appellate jurisdiction.
>
> The Committee intends for the jurisdictional language to be construed in accordance with the objectives of the Act and these concerns. If, for example, a patent claim is manipulatively joined to an antitrust action but severed or dismissed before final decision of the antitrust claim, jurisdiction over the appeal of the antitrust claim should not be changed by this Act but should rest with the regional court of appeals.

Id. Here, the district court's use of Rule 54(b) to separate the certain nonpatent claims for partial final judgment fits within the scope of the committee's intent. Because the district court both dismissed all patent claims from this case and separated its decision on the merits of the nonpatent claims through the grant of a partial final judgment under Rule 54(b), we have appellate jurisdiction over the partial final judgment.

DISCUSSION

I. Copyright Claims

A. Importation

[7] Denbicare claims that Toys has infringed its exclusive right of distribution in a copyrighted work — the box in

which the diapers are packaged — through the sale of copies imported without authorization. Section 106 of Title 17 of the United States Code grants a copyright owner the exclusive right to distribute copies of the copyrighted work. Section 602 of the Act provides that "[i]mportation into the United States,[4] without the authority of the owner of copyright under this title, of copies or phonorecords of a work that have been acquired outside the United States is an infringement of the exclusive right to distribute copies or phonorecords under section 106." 17 U.S.C. § 602(a). Section 602 bars unauthorized importation *only* of "copies . . . that have been acquired outside the United States." *Id.* The legislative history of the Act highlights this fact: "Section 602(a) first states the general rule that unauthorized importation is an infringement merely if the copies or phonorecords 'have been acquired outside the United States'. . . ." H.R. Rep. No. 1476, 94th Cong., 2d Sess. 169 (1976), *reprinted in* 1976 U.S.C.C.A.N. 5659, 5785. Given the 1976 Act's definition of the term "United States,"[5]

[4]The 1976 Copyright Act does not define that phrase, or the word "importation," and we have found no reported cases interpreting those terms as used in § 602. We have also found no reported cases concerning the general applicability of copyright laws in a foreign trade zone, although courts have held that patent and trademark laws apply in such zones. *Babbit Elecs., Inc. v. Dynascan Corp.*, 38 F.3d 1161, 1179-80 (11th Cir. 1994) (trademarks); *Ocean Garden*, 953 F.2d at 504-06 (trademarks); *A.T. Cross Co. v. Sunil Trading Corp.*, 467 F. Supp. 47 (S.D.N.Y. 1979) (trademarks); *G.D. Searle & Co. v. Byron Chem. Co.*, 223 F. Supp. 172, 174 (E.D.N.Y. 1963) (patent). In addition, at least one Customs Decision has held that "[f]oreign goods entering a foreign trade zone are considered to be physically imported into the United States" though those goods are not subject to import duties in the zone. 16 Cust. B. & Dec. 701, 702 (1981) (C.S.D. 82-16). This decision relied on a prior customs decision holding that "unless it clearly appears that Congress intended otherwise, the term 'importation' . . . mean[s] the bringing of goods within the jurisdictional limits of the United States with intent to unlade." *Id.* (citing *American Customs Brokerage Co. v. United States*, 72 Cust. Ct. 245, 375 F. Supp. 1360 (1974)).

[5]"The 'United States', when used in a geographical sense, comprises the several States, the District of Columbia and the Commonwealth of Puerto Rico, and the organized territories under the jurisdiction of the United States Government." 17 U.S.C. § 101.

it seems highly improbable that Congress intended, without remarking on the fact at all, that Foreign Trade Zones on the geographic and political territory of the United States be considered "outside the United States" for purposes of the acquisition required for a violation of § 602 by importation. As the Customs Court has noted, the laws authorizing these zones draw "a patent distinction . . . between the boundaries delineating the geographical territory of the United States and the Customs territory of the United States." *Hawaiian Indep. Refinery v. United States*, 81 Cust. Ct. 117, 121-22, 460 F. Supp. 1249, 1253 (Cust. Ct. 1978). Because the diapers were already in the United States, Toys did not violate Denbicare's exclusive distribution right under § 602.

B. First Sale

[8] A copyright owner receives, under 17 U.S.C. § 106(3), the exclusive right "to distribute copies or phonorecords of the copyrighted work to the public by sale or other transfer of ownership, or by rental, lease, or lending" or to authorize such distribution. While Toys is not liable for violating the distribution right by an importation prohibited by § 602, its sales of the diapers to the public could violate the basic distribution right itself, since Denbicare, as copyright owner, has the exclusive right to sell copies to the public and Toys does not have Denbicare's authorization for its sales. Denbicare's exclusive distribution right, however, is limited by the "first sale" doctrine set forth in 17 U.S.C. § 109(a): "the owner of a particular copy or phonorecord lawfully made under this title . . . is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy or phonorecord." Whether Toys' sales of the diapers infringe Denbicare's exclusive distribution right therefore turns on whether or not the diapers have already been the subject of a first sale. Toys asserts, and the district court ruled, that the sale of the diapers by the bankruptcy trustee constituted a first sale.

Denbicare argues that there has been no first sale for the purposes of § 109 because such a sale must be in the United States and the sale by the bankruptcy trustee occurred in a foreign trade zone and not in the United States. The requirement that the sale be in the United States comes from our opinions in *BMG Music v. Perez*, 952 F.2d 318 (9th Cir. 1991), *cert. denied*, 505 U.S. 1206 (1992), and *Parfums Givenchy, Inc. v. Drug Emporium, Inc.*, 38 F.3d 477 (9th Cir. 1994), *cert. denied*, 115 S. Ct. 1315 (1995), cases which examined the relationship between the importation right in § 602 and the first-sale doctrine of § 109. *BMG Music* held that "[t]he words 'lawfully made under this title' in § 109(a) grant first sale protection only to copies *legally made and sold* in the United States." 952 F.2d at 319 (emphasis supplied). *Parfums Givenchy* acknowledged widespread criticism of this language,[6] which, "if taken literally, would render the first sale doctrine wholly inapplicable to foreign manufactured goods, even after the goods have been lawfully imported into the United States with the authorization of the U.S. copyright holder." 38 F.3d at 482 n.8. Agreeing that "such a result would be untenable, and that nothing in the legislative history or text of [the 1976 Copyright Act] supports such an interpretation," we held that the language in *BMG Music* was limited to the facts of that case and "sales *abroad* of foreign manufactured United States copyrighted materials do not terminate the United States copyright holder's exclusive distribution rights in the United States under §§ 106 and 602(a)." *Id.* (citations omitted) (emphasis in original). Thus, under the law of the circuit, § 109 applies to copies made abroad only if the copies have been sold in the United States by the copyright owner or with its authority.

[9] In this case, there was such a sale. As discussed above, the foreign trade zone is part of the United States, although it is not part of its customs territory. The bankruptcy trustee's

[6] *See, e.g.*, Paul Goldstein, *Copyright* § 5.6.1.2.a.

sale of the diapers in the foreign trade zone was therefore a sale in the United States sufficient to bring § 109 into play.

[10] Denbicare next argues that no first sale occurred because such a sale requires the consent of the copyright owner and it consented only to the sale of the diapers outside the United States and Canada. It is clear, however, that McCoy consented to the first sale, i.e., the sale of the diapers by the bankruptcy trustee, although with a restriction (imposed through an injunction issued by the bankruptcy court) that the buyers not resell the diapers in the United States or Canada. The bankruptcy trustee filed an application to sell the diapers. McCoy filed an objection to the sale, stating that the distribution of the diapers in the United States or Canada would injure his business and requesting that the court not approve the sale unless it also enjoined the buyers from reselling the diapers in those countries. Based on a "stipulation . . . stated in open court" by McCoy, the debtor, and the purchasers, the court enjoined the prospective purchasers of the diapers from reselling them in the United States and Canada and filed an order approving the sale.

When McCoy objected to the sale of the diapers, he could have exercised his right as the owner of the copyright in the diaper boxes to prevent the bankruptcy trustee's sale altogether. The proposed sale would have constituted a distribution of copies of the copyrighted work, and McCoy, as the copyright owner, had the exclusive right under § 106(3) to make or authorize such distributions. Without his authorization, the bankruptcy trustee's sale — a sale of copies located within the physical territory of the United States that required the approval of a federal court in California — would have been an infringement of his copyright. Instead of seeking to prevent this infringing sale, however, McCoy stipulated in court that the sale could proceed if the buyers were enjoined from reselling in the United States and Canada. Thus, McCoy consented to the sale of the copies; the fact that the buyers later violated the conditions imposed on the sale does not

negate his consent. *Cf. United States v. Wise*, 550 F.2d 1180, 1187 (9th Cir. 1977).

Finally, Denbicare argues that no first sale occurred because it received no economic reward as copyright owner from the sale. Denbicare bases its argument that such a reward is a prerequisite to a first sale not on the language or history of § 109 but on *Platt & Munk Co. v. Republic Graphics, Inc.*, 315 F.2d 847 (2d Cir. 1963), a case interpreting § 27 of the 1909 Copyright Act, the predecessor provision to § 109.

Even if the "reward" test of *Platt & Munk* is a proper interpretation of § 109(a) in civil cases in this circuit,[7] it is not relevant to this case. *Platt & Munk* involved a situation in which the defendant had not acquired the copies through a prior sale that was allegedly a first sale; rather, the defendant owned the copies because it had manufactured them under authority of the copyright owner, and it argued that this ownership qualified it for the exemption, granted by § 27, from the copyright owner's exclusive distribution right. Toys does not argue that the bankruptcy trustee was entitled to sell the diaper boxes because the debtor owned them through its lawful manufacture of them while the debtor owned the copyright. Instead, Toys argues that the bankruptcy trustee's sale was a first sale because the owner of the copyright at the time of the sale — McCoy — consented to that sale. Because the "reward" test of *Platt & Munk* is designed to determine when a sale that is "not . . . truly voluntary" is a first sale, 315 F.2d at 854, that test is irrelevant here: the bankruptcy trustee's sale was voluntary as to Denbicare and to McCoy because McCoy con-

[7]We rejected the test in the criminal context in *United States v. Atherton*, 561 F.2d 747, 751 (9th Cir. 1977), and one commentator has questioned whether or not this interpretation of § 109's predecessor should be applied to § 109 at all, given the differences between the two sections and the two Acts. 2 Melville B. Nimmer & David Nimmer, *Nimmer on Copyright* § 8.12[B][3][b]-[c].

sented. Just as courts will not inquire into the sufficiency of consideration, there is no justification for reexamining the adequacy of the "reward" received by the copyright owner in an alleged first sale where the owner has consented to that sale.

II. Trademark Claims

[11] Denbicare appeals the district court's grant of summary judgment, based on the "first sale" doctrine, on its trademark infringement claims. In *Sebastian Int'l, Inc. v. Longs Drug Stores Corp.*, 53 F.3d 1073 (9th Cir.), *cert. denied*, 116 S. Ct. 302 (1995), we held that, subject to certain exceptions, "the right of a producer to control distribution of its trademarked product does not extend beyond the first sale of the product. Resale by the first purchaser of the original article under the producer's trademark is neither trademark infringement nor unfair competition." *Id.* at 1074. Thus, if the bankruptcy trustee's sale of the diapers was a first sale, Toys' resale of the diapers would not in itself infringe Denbicare's trademark. Denbicare argues that the trustee's sale was not a trademark first sale for the same reasons that it argued it was not a copyright first sale. Denbicare has not argued that different criteria apply in determining what constitutes a first sale in the copyright and trademark contexts. Since the trustee's sale qualified as a first sale for copyright purposes, it is a trademark first sale as well.

Denbicare tries to bring itself within an exception to the "first sale" rule by arguing that the rule does not apply if the goods sold subsequently deteriorate in the chain of distribution, citing *Shell Oil Co. v. Commercial Petroleum, Inc.*, 733 F. Supp. 40 (W.D.N.C. 1989), *aff'd* 928 F.2d 104 (4th Cir. 1991); *Adolph Coors Co. v. A. Genderson & Sons, Inc.*, 486 F. Supp. 131 (D. Colo. 1980); *Polaroid Corp. v. Blue Dot Corp.*, 214 U.S.P.Q. 192 (D.N.J. 1981), *aff'd* 688 F.2d 823 (3d Cir. 1982); *J.C. Penney Co. v. Charbeth's Little Gen. Store*, 185 U.S.P.Q. 254 (E.D.N.Y. 1975); and *J.C. Penney*

Co. v. Parrish Co., 335 F. Supp. 209 (D. Idaho 1971). Denbicare, however, has not raised any genuine issue of material fact that the diapers in this case deteriorated in the distribution chain after the trustee's sale or were the type of product subject to such deterioration. At best, Denbicare has raised a triable issue as to whether the diapers were defective when they arrived in the foreign trade zone and were sold by the trustee. Even if Denbicare can prove that the diapers were defective at the time of the trustee's sale, it will only have demonstrated that it consented to the release of the diapers into commerce with knowledge of their defectiveness; that knowledge and consent at the time of the sale bar Denbicare from now asserting that it has the right, despite the "first sale" doctrine, to prevent Toys from selling the diapers in order to protect the reputation of its mark from injuries stemming from the sale of defective diapers.

Denbicare also argues that this case is controlled by *A. Bourjois & Co. v. Katzel*, 260 U.S. 689 (1923). We have interpreted the holding in *Katzel* as being limited to "cases presenting the same 'equities' " as that case. *NEC Elecs. v. CAL Circuit Abco*, 810 F.2d 1506, 1510 (9th Cir.), *cert. denied*, 484 U.S. 851 (1987). This case does not fall within the "equities" of *Katzel*, and, under *NEC Elecs.*, the *Katzel* decision does not control this case.

Finally, Denbicare argues that the bankruptcy court's injunction, which barred the original purchasers of the diapers from selling them in the United States or Canada, created an express condition that ran with an implied license to sell the goods. Arguing by analogy to patent law, where a first sale is considered to grant the purchaser an implied license to use or sell the patented good or process, Denbicare suggests that the trademark "first sale" doctrine contains an implied license component. Denbicare cites no authority for this proposition and offers no explanation of why trademark's "first sale" doctrine should be made to conform to patent law, rather than to copyright law, which holds that conditions placed on a first

sale do not run with the goods. *See, e.g., American Int'l Pictures, Inc. v. Foreman*, 576 F.2d 661, 664 (5th Cir. 1978) ("first sale" buyer's disregard of restrictions on resale does not make buyer — or subsequent buyer — an infringer; copyright holder's remedy is suit for breach of contract containing the restrictions); *United States v. Wise*, 550 F.2d 1180, 1187 (9th Cir.) (after first sale, "exclusive right to vend the transferred copy rests with the vendee, who is not restricted by statute from further transfers of that copy, even though in breach of an agreement restricting its sale"; vendee "may be liable for the breach but he is not guilty of infringement"), *cert. denied*, 434 U.S. 929 (1977).

III. Unfair Competition Claims

Denbicare appeals the district court's grant of summary judgment to Toys on the various federal and state unfair competition claims. The district court held that its ruling that the "first sale" doctrine defeated Denbicare's trademark claims also defeated "those causes of action that sound in trademark," and "all the . . . unfair competition causes of action" were therefore dismissed. Denbicare now argues that "some" of its unfair competition claims are based on deceptive trade practices rather than trademark infringement, but it does not identify which claims those are.

Denbicare's claim under the Lanham Act § 43(a), 15 U.S.C. § 1125(a), clearly sounds in trademark; Denbicare complains that Toys' "use of the mark 'DenBi' and the trade dress, style, and labeling of plaintiffs[ ] . . . have the effect of creating a false designation of origin or a false description as to the source" of the goods. Denbicare also alleges that Toys "competed unfairly by selling smuggled diapers at a devastating price advantage," but it has failed to cite any authority indicating the Lanham Act offers a remedy for the sale of "smuggled" products at a price advantage, even if it has raised a genuine issue as to whether the diapers were smuggled. Denbicare argues that Toys sold the diapers without marking

them as defective or irregular, but even if Denbicare has raised a genuine issue as to irregularity or defectiveness, it consented to the original sale of the diapers without such markings. Denbicare's common-law unfair competition cause of action alleges that Toys is "palming or passing off [the Hong Kong diapers] as those of DENBICARE," but the diapers Toys sold were in fact manufactured for the trademark owner from which Denbicare bought its trademark rights.

Denbicare also alleges that Toys violated § 17200 of California's Business and Professions Code.[8] "[S]tate common law claims of unfair competition and actions pursuant to California Business and Professions Code § 17200 are 'substantially congruent' to claims made under the Lanham Act." *Cleary v. News Corp.*, 30 F.3d 1255, 1262-63 (9th Cir. 1994) (citing *Academy of Motion Picture Arts & Sciences v. Creative House Promotions, Inc.*, 944 F.2d 1446, 1457 (9th Cir. 1991)). Thus, since dismissal of Denbicare's Lanham Act claim was proper, dismissal of its § 17200 claim was proper as well.

Finally, Denbicare claimed Toys violated § 17500 of the Business and Professions Code, which prohibits making any "statement," in connection with the sale of personal property, "which is untrue or misleading, and which is known, or which by the exercise of reasonable care should be known, to be untrue or misleading." At least one reported case has held that "imitation of . . . distinctive packaging and trade dress" violates § 17500, *St. Ives Lab., Inc. v. Nature's Own Lab.*, 529 F. Supp. 347, 350 (C.D. Cal. 1981), but that case held that the same conduct also violated § 43(a) of the Lanham Act. Thus, even if Denbicare has alleged conduct that would violate

[8] "As used in this chapter, unfair competition shall mean and include any unlawful, unfair or fraudulent business act or practice and unfair, deceptive, untrue or misleading advertising and any act prohibited by Chapter 1 (commencing with Section 17500) of Part 3 of Division 7 of the Business and Professions Code."

§ 17500, that claim was properly dismissed since the Lanham Act unfair competition claim was properly dismissed.

IV. Tortious Denial of Contract Claim

Denbicare appeals the district court's grant of summary judgment to Toys on Denbicare's claim of tortious denial of contract. The district court held that New Jersey law governed the contract between the parties and granted summary judgment to Toys since New Jersey law does not recognize a tort of denial of contract. Denbicare argues that the district court erred in ruling that New Jersey law, rather than California law, governs the contract.

This issue is now moot because while this appeal was pending the California Supreme Court abolished the tort of denial of contract. *Freeman & Mills, Inc. v. Belcher Oil Co.*, 900 P.2d 669 (Cal. 1995). Thus, even if California law governed the contract, Toys would still have been entitled to summary judgment against Denbicare's claim for tortious denial. Therefore, the district court's grant of summary judgment is affirmed.

CONCLUSION

We have jurisdiction over this appeal because the district court eliminated all patent claims from this case and its grant of a partial final judgment on certain nonpatent issues sufficiently separated out the nonpatent issues. The district court's grant of summary judgment for Toys on Denbicare's copyright, trademark, unfair competition, and tortious denial of contract claims is

AFFIRMED.

APPENDIX B

APPENDIX B

No. 94-16615

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

DENBICARE U.S.A. INC. and
ERNEST MCCOY,
Plaintiffs-Appellants,

v.

TOYS "R" US, INC.,
Defendant-Appellee.

ORDER

D.C. No. CV-87-05746-TEH

FILED
JUL 18 1996

CATHY A. CATTERSON, CLERK
U.S. COURT OF APPEALS

Before: ALARCON, LEAVY, and KLEINFELD, Circuit Judges.

The panel has voted to deny appellants' petition for rehearing. Judges Leavy and Kleinfeld have voted to reject the suggestion for rehearing en banc, and Judge Alarcon has so recommended.

The full court has been advised of the suggestion for rehearing en banc and no active judge has requested a vote on whether to rehear the matter en banc. Fed. R. App. P. 35.

The petition for rehearing is DENIED and the suggestion for rehearing en banc is REJECTED.